

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| HERBERT ROUNICK | : | :DETERMINATION |
| for Redetermination of a Deficiency or for | : | |
| Refund of Personal Income Tax under Article 22 | : | |
| of the Tax Law for the Period October 1, 1980 | : | |
| through December 15, 1980. | : | |

Petitioner, Herbert Rounick, 15 West 53rd Street - 38 A/F, New York, New York 10019, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the period October 1, 1980 through December 15, 1980 (File No. 803076).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on June 7, 1989 at 9:15 A.M., with all briefs to be filed by November 10, 1989. Petitioner appeared by Kostelanetz, Ritholz, Tigie & Fink (Jules Ritholz, Esq., and Keith D. Krakaur, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

- I. Whether the Notice of Deficiency was barred by the statute of limitations.
- II. Whether petitioner was a person required to collect, truthfully account for and pay over withholding taxes with respect to Don Sophisticates, Inc. for the period at issue and willfully failed to do so, thereby becoming liable for a penalty imposed pursuant to Tax Law § 685(g).

FINDINGS OF FACT

On December 23, 1985, the Division of Taxation ("Division") issued a Notice of Deficiency to petitioner, Herbert Rounick, asserting a deficiency of personal income tax for the year 1980 in the amount of \$57,338.15. A Statement of Deficiency, which was issued on the

same date, explained that the Division was asserting the deficiency against petitioner as a person required to collect, truthfully account for and pay over the taxes withheld from the wages of the employees of Don Sophisticates, Inc. ("DSI") for the period October 1, 1980 through December 15, 1980.

During the period in issue, DSI was in the business of manufacturing women's apparel under the trademark of Charlotte Ford. The garments were sold in department stores and specialty stores in the United States.

Major shareholders of the corporation included Coca-Cola which owned 20 percent, Caressa Shoe Corporation which owned 31 percent, Sumair which owned 4 percent and petitioner who owned 31 percent. The balance of the shares was owned by the general public.

During the period in issue, petitioner was the chairman of the board and chief executive officer of DSI. In this position, his time was consumed in manufacturing, merchandising and sales. Petitioner's duties required him to travel a minimum of 50 percent of the year to such places as India, Brazil, Portugal, Spain, Korea and China.

In the early part of December 1980, it was projected at the board of directors meeting that DSI would have a profit for the year of between \$400,000.00 to \$500,000.00. After the meeting, petitioner went on a vacation to Mexico. Petitioner returned to New York on or about January 4, 1981. After staying in New York for one or two days, petitioner proceeded to Hong Kong on business of the company.

During the last week of January 1981, Mr. Cohen, who was DSI's chief financial officer, remitted an Employer's Return of Tax Withheld for five consecutive periods commencing October 1, 1980. Each of the returns was accompanied by a check for the amount shown due on the returns.

While he was in Hong Kong, petitioner was advised by Mr. Cohen that there was difficulty with the projection of profits and that a large loss was anticipated. Petitioner immediately returned to New York and on February 2, 1981 went into his office to review the new projected financial position. In the course of a meeting, petitioner specifically asked

Mr. Cohen about the prospect of the officers being held liable for withholding taxes.

Mr. Cohen responded that all New York State withholding taxes had been paid.

A few days after the first meeting, petitioner and Mr. Cohen had another meeting regarding DSI's financial position. At that time there was no concern about New York State withholding tax because the participants in the meeting felt that the taxes in issue had been paid. However, they did make arrangements to pay Federal taxes.

The board of directors of DSI continued to hold meetings and on February 18th or 19th, 1981 the decision was made to file a petition for relief under Chapter 11 of Title 11 of the United States Bankruptcy Act. When DSI filed its petition, it was given the status of debtor in possession and new bank accounts were opened under the name Don Sophisticates, Inc., Debtor in Possession. The new checks had debtor in possession stamped on them. The prior bank account was frozen by the court.

In 1981 Norstar Bank, which was known at that time as State Bank of Albany, received checks in payment of New York State withholding taxes and was responsible for depositing such checks. A check in payment of New York State withholding taxes deposited by the State Bank of Albany in 1981 would ordinarily have reached the Federal Reserve Bank in Utica for processing within one business day after deposit.

Each of the withholding tax returns and checks mailed by Mr. Cohen on behalf of DSI were received by the Division on February 3, 1981 except for the return for the period November 1, 1980 through November 15, 1980 which was received on February 1, 1981. Thereafter, the checks were dishonored because of insufficient funds. Those checks which were available at the time of the hearing show that they were not processed by the Utica office of the Federal Reserve Bank of New York until February 18, 1981. A second date stamp reveals that the Utica office of the Federal Reserve Bank of New York processed the checks for a second time on February 24, 1981.

The dishonored checks were the basis for the Notice of Deficiency which was issued to petitioner.

In or about the end of March 1981, petitioner was discharged by the board of directors of DSI. Petitioner left DSI in April 1981. DSI continued to operate as a debtor in possession until on or about the end of 1983.

On or about April 6, 1981, the Division issued to DSI five notices and demands for payment of New York State and/or New York City withholding tax due. The notices, which were dated April 15, 1981, indicated that the checks which had accompanied the returns for the periods October 1, 1980 through December 15, 1980 had been dishonored. At the same time the Division issued the notices and demands, it issued notices of unpaid remittance to DSI which stated that certain checks had been returned unpaid by the bank because of insufficient funds.

DSI maintained its checking account with Chemical Bank. When DSI drew a check on its account with Chemical Bank, the funds would be provided by Citibank. In practice, Mr. Cohen called upon Citibank to provide funds as needed. Citibank provided the funds because it had standby letters of credit in excess of \$2,000,000.00 from Caressa Corporation and approximately \$2,000,000.00 from Coca-Cola. It also had petitioner's personal guarantee.

Until DSI filed its petition for bankruptcy, there were sufficient funds in DSI's checking account to cover the checks for withholding taxes which were drafted during the last week of January 1981. Moreover, during petitioner's tenure, DSI never had a check dishonored for insufficient funds.

Petitioner never saw the notices and demands or the notices of unpaid remittances (Finding of Fact "14") while he was at DSI and, until 1986, he was under the impression that DSI's withholding taxes had been paid.

Although he rarely did so, petitioner had the authority to sign checks. Similarly, although he had the authority to sign tax returns, petitioner had no recollection at the time of the hearing of having done so. Petitioner hired DSI's chief financial officer.

SUMMARY OF PETITIONER'S POSITION

Briefly, it is petitioner's position that the Notice of Deficiency is barred by the statute of

limitations. In this regard, petitioner maintains that language in Matter of Wolfstich v. New York State Tax Commn. (106 AD2d 745, 483 NYS2d 779) that there is no period of limitation in these matters should not be followed. Petitioner also argues that he did not willfully fail to pay tax and that the reason New York did not receive the funds sought is because of delay in depositing the checks until after DSI entered bankruptcy.

CONCLUSIONS OF LAW

A. In this matter, petitioner has presented an extensive argument to support his position that the Notice of Deficiency was barred by the statute of limitations and that language to the contrary in Matter of Wolfstich v. New York State Tax Commn. (supra) should not be followed.

In general, Tax Law § 683(a) provides that personal income taxes must be assessed within three years after a return is filed, whether or not such return is filed on or after the due date. In Matter of Wolfstich v. New York State Tax Commn. (supra), the court held that the penalty imposed against an officer for failure to pay withholding taxes is distinct from the penalty imposed against a corporation for the same taxes. Therefore, it was held that a Notice of Deficiency which asserted a penalty against an officer for failure to pay withholding taxes could be asserted at any time after the corporate assessment is rendered.

In Matter of Sidney Friedman (Tax Appeals Tribunal, July 8, 1988), the Tax Appeals Tribunal found Wolfstich dispositive when it rejected an argument that a Notice of Deficiency which asserted a deficiency pursuant to Tax Law § 685(g) was barred by the statute of limitations.

In view of the foregoing, it is concluded that the principle of stare decisis requires that Wolfstich be found controlling. Therefore, the Notice of Deficiency was not barred by the statute of limitations.

B. Where a person is required to collect, truthfully account for and pay over withholding taxes and willfully fails to collect and pay over such taxes, Tax Law § 685(g) imposes on such person "a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

C. Tax Law § 685(n) defines "person", for purposes of Tax Law § 685(g), as follows:

"the term person includes an individual, corporation or partnership or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

D. In this matter, petitioner has not presented any evidence or argument that he was not a "person" within the meaning of Tax Law § 685(g) and (n). Moreover, in view of the facts that he owned a substantial portion of the outstanding stock, had the authority to pay corporate obligations, hired the chief financial officer of DSI and was responsible for the overall operation of the company, it is concluded that petitioner was a "person" within the meaning of Tax Law § 685(g) (see, e.g., Matter of Malkin v. Tully, 65 AD2d 228, 412 NYS2d 186).

E. The fact that one is determined to be a responsible officer does not necessarily mean that the person is liable for the taxes in issue (see, e.g., Matter of Lyon, Tax Appeals Tribunal, June 3, 1988). Tax Law § 685(g) penalizes responsible persons who willfully fail to withhold and pay over withholding taxes.

The test of whether conduct was willful within the meaning of Tax Law § 685(g) has been set forth in Matter of Levin v. Gallman (42 NY2d 32, 34, 396 NYS2d 623, 624) as follows:

"whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes [citations omitted]. No showing of intent to deprive the Government of its money is necessary but only something more than accidental nonpayment is required [citations omitted]."

The crux of the willfulness standard "is that the person must voluntarily and consciously direct the trust fund monies from the State to someone else" (Matter of Gallo, Tax Appeals Tribunal, September 9, 1988). Therefore, a lack of knowledge that withholding taxes were not being paid over at the time of the failure would negate a finding that an act was voluntarily and consciously done (Matter of Gallo, supra; Matter of Flax, Tax Appeals Tribunal, September 9, 1988; Matter of Lyon, supra). Nevertheless, if a responsible officer disregards his corporate responsibility to see that taxes are paid, the conduct can be willful despite a lack of actual knowledge (Matter of Gallo, supra; Matter of Lyon, supra; Matter of Flax, supra).

F. It is concluded that petitioner's conduct was not willful within the meaning of Tax Law § 685(g). The record shows that upon learning that DSI was having financial difficulty petitioner specifically inquired as to the status of the withholding tax payments to insure that the withholding taxes were paid. Since he was told by Mr. Cohen that the taxes had been satisfied, petitioner was not required, under the circumstances presented herein, to take further action. In this regard, the record shows that petitioner did not know that the checks were dishonored until long after the fact or have reason to suspect that they would be dishonored at the time Mr. Cohen stated that the New York State withholding tax liabilities had been satisfied. The record also shows that the reason the withholding tax payments in issue were not satisfied was because of a delay on the part of one or more individuals, who were outside of petitioner's control, in depositing the checks. This delay should not inure to petitioner's detriment. Furthermore, petitioner has accurately argued that, in the past, individuals have prevailed on similar fact patterns at both the State and Federal levels (Dudley v. United States, 428 F2d 1196; Matter of Robert A. Himoff, State Tax Commn., January 9, 1981). Thus, the record supports petitioner's contention that he did not willfully fail to satisfy DSI's withholding tax liability.

Before concluding, it is briefly noted that the Division's arguments in opposition to the foregoing results are without merit. First, contrary to the assertion in the Division's brief, there is evidence in the record which indicates that there were sufficient funds to cover the checks at the time the checks were issued. Moreover, the bankruptcy petition, which the Division relies upon to support its position, shows that DSI had a cash shortage on February 19, 1981. This does not show that DSI was insolvent at the time DSI mailed the withholding tax payments to the State Bank of Albany. Similarly, one cannot impute willfulness to petitioner from DSI's delay in making the withholding tax payments. Lastly, contrary to the assertions in the Division's brief, the notices and demands state when the returns and checks were received by the State Bank of Albany and also show that the checks were dishonored for insufficient funds.

G. The petition of Herbert Rounick is granted and the Notice of Deficiency, dated

December 23, 1985, is cancelled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE